



## FAIR POLITICAL PRACTICES COMMISSION

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January 15, 2002

Roger A. Brown  
38 North Washington Street  
Post Office Box 475  
Sonora, CA 95370

**Re: Your Request for Advice  
Our File No. A-01-286**

Dear Mr. Brown:

This letter is in response to your request for reconsideration of advice provided under the Political Reform Act (the "Act").<sup>1</sup> Specifically, you ask for reconsideration of advice provided to Colin J. Coffey on behalf of Peninsula Health Care District ("District") Director Tarilyn Hanko, Advice Letter No. A-01-064.

### FACTS

In the *Coffey* Advice Letter, we provided advice to Director Hanko regarding a potential conflict of interest based on bonus payments that the director received from her employer which were due to her based on sales to business entities that were applicants before the District. The District is negotiating a contract with Mills Peninsula Health System ("MPHS"), a wholly owned subsidiary of Sutter Health ("Sutter"). Both MPHS and Sutter are California non-profit public benefit corporations.

Director Hanko is employed by Baxter Healthcare Corporation, a Fortune 500 company conducting business worldwide in pharmaceutical and healthcare supplies. She also owns stock that has a value in excess of \$2,000. Director Hanko is a "Pharmaceutical Products Specialist" for Baxter. Her duties consist mainly of marketing certain Baxter pharmaceutical products to healthcare providers, including hospitals, long term care providers, surgery centers, and other health services providers. Her efforts on behalf of Baxter are focused on educating healthcare professionals in these various

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<sup>1</sup> Government Code §§ 81000 - 91014. Commission regulations appear at Title 2, §§ 18109-18997, of the California Code of Regulations.

settings about Baxter products available to them, including product introductions and follow-up utilization and general information about the use of the products. Therefore, her representation of Baxter encompasses pre and post sales presentations.

Director Hanco does not “take orders” or conduct actual sales transactions. Healthcare providers purchase Baxter products through independent specialty wholesale companies with whom the providers conduct orders and purchase transactions. Baxter intends Director Hanco’s representation to increase awareness and use of Baxter’s products by healthcare providers within her coverage territory. Baxter therefore provides potential bonus payments to its representatives, including Director Hanco, based on overall sales of Baxter products within the representative’s territory. The company annually establishes budgets for projected sales of product groups within a territory. It then creates a formula based on a target that is a percentage of projected total sales for a representative’s product group and territory. The target (e.g., 85% of projected gross sales for the calendar year) becomes a minimum threshold of overall product sales in the territory before any incentive income will be paid. If, during the year, the overall sales of the product group exceed the targeted percentage of projected sales, the representative may receive incentive compensation that increases with the amount of overall sales exceeding the minimum threshold target of gross sales. The budget and target sales formulas do not take into consideration any individual efforts by Director Hanco as a Baxter representative. The company cannot trace individual product sales to its representatives. Therefore, the budget and target sales formulas are based entirely on product gross sales performance. The company reserves the right to, and occasionally does, change its projected sales budgets and threshold targets during the course of a year based on its evaluation of the company’s health and changing market conditions. Likewise, the company reserves the right to cancel the incentive compensation program altogether, and employee representatives must acknowledge in writing that the incentive program creates no express or implied contractual right to extra compensation.

The District itself has no relationship with Baxter. MPHS, however, purchases Baxter products. During calendar year 2000, Baxter sales to MPHS, including Peninsula and Mills hospitals (Mills is an outpatient services facility) amounted to approximately \$387,400.

Your letter specifically questions step 3, in the standard conflict of interest analysis. In the *Coffey* letter we concluded:

“In the present case, the amount of Director Hanco’s ‘incentive compensation’ is based on the total volume of sales within her coverage territory. Director Hanco is also able to estimate the portion of her ‘incentive compensation’ that is attributable to sales to MPHS..... Accordingly, Director Hanco has an economic interest in MPHS.”

## QUESTIONS/DISCUSSION

A public official may not make, participate in making, or in any way attempt to use his or her official position to influence a governmental decision in which the official knows, or has reason to know, that he or she has a financial interest. (§ 87100.) The Commission has developed an eight-step approach for determining whether an individual has a disqualifying financial interest in a decision. (Reg. 18700(b).) Your request for reconsideration focuses only on step 3: “identifying the public official’s economic interests.” (Reg. 18703.) Thus, we will only discuss this step in the analysis.

### *1. The Definition of “Source of Income;” The Application of Regulation 18703.3.*

Section 87103 does not define who is considered the “source” of income. Thus, the “source” of income has been determined through Commission advice based on the facts of specific situations or by Commission regulations. In most cases, the actual payor is the source of income. However, while the person who actually writes the payment instrument is a generally the source, it is not always the case. In some cases, both by regulation and in Commission advice, the Commission has looked beyond the person signing a check to find, based on the specific facts, that some other person may also be considered the source of that income.

For example, in the *Hentschke* Advice Letter, No. A-80-069, a Carlsbad planning commissioner who was employed by a closely held corporation was confronted with a decision that would not affect the corporation, but would substantially affect the president/majority shareholder of the corporation. We advised:

“In keeping with the purposes of the Act, we conclude that in this case the president/majority shareholder of the corporation for which Mr. Larson works may also be considered a source of income to Mr. Larson. Although for other purposes the corporation would be considered Mr. Larson’s source of income, there can be no question that in a closely-held corporation situation such as here the president/majority shareholder of a corporation effectively controls the employment relationship itself. Accordingly, we conclude that the majority shareholder is a source of income to Mr. Larson and that he should therefore disqualify himself from any decision which would have a material financial effect on the shareholder.”

Further, § 87100, by its express terms, provides income may be imputed from the actual source to some other person. That section provides that it is reasonably foreseeable that the decision will have a material financial effect, distinguishable from its effect on the public generally, on the official’s economic interest where the effect is on a *business entity which is a parent or subsidiary of, or is otherwise related to, a business*

*entity in which the official has a financial interest.* Again, this analysis does not limit the source to the payor. (Regulation 18703.1(c).)

The commission income regulation is another incarnation of this analysis. Commission income is governed by regulation 18703.3(c)(2). However, “commission income” is defined in that regulation to include only “gross payments received as a result of services rendered as a broker, agent, or other salesperson *for* a specific sale or similar transaction.” (Emphasis added.) You note that under your facts, there was no “specific sale or similar transaction.” This is a necessary part of the definition of “commission income.” Since the payment in question does not fit this definition, the payment in question would not be commission income and would not be analyzed under regulation 18703.3(c)(2).<sup>2</sup>

*2. The Contingent Nature of Future Bonus Payments Does Not Affect the Characterization of Who is The Source of Payments Already Received.*

The only factual basis offered to distinguish *Larsen* (Advice Ltr. No. I-89-555) and *Anaforian* (Advice Ltr. No. I-90-312) is the ability of the employer to discontinue the bonus program in question. This same argument was offered in the context of the original advice request. We advised:

“In the present case, the amount of Director Hanko’s ‘incentive compensation’ is based on the total volume of sales within her coverage territory. Director Hanko is also able to estimate the portion of her ‘incentive compensation’ that is attributable to sales to MPHS. The only feature that distinguishes Director Hanko’s ‘incentive compensation’ from the bonuses in *Larsen* and *Anaforian* is that Baxter reserves the right to cancel the ‘incentive compensation’ program, and employee representatives must acknowledge in writing that the program does not create a ‘right’ to extra compensation. Therefore, the bonuses are not automatic in the same sense as the bonuses at issue in *Larsen* and *Anaforian*. However, we conclude that this is a distinction without a difference. The fact remains that the ‘incentive compensation’ program is currently in effect and that, as long as the program is in effect, Director Hanko will be entitled to receive ‘incentive compensation’ on the total sales volume in her territory, which includes MPHS. Therefore, we conclude that Director Hanko’s ‘incentive compensation’ is sufficiently similar to commission income such that MPHS is a source of income to her.”

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<sup>2</sup> You believe that the adoption of the regulation was intended to preclude the Commission’s interpretation of the “source” of income in other contexts, other than where the income is “commission income” as defined in the regulation. Nothing in the language of the regulation or rulemaking file associated with the adoption of the regulation supports this interpretation.

However, the contingent nature of the bonus program in the future will not affect the characterization of the source of income which has already been received by the official. In the original *Coffey* letter (No. A-01-064), the facts provided by Mr. Coffey were: “Based on the year 2000 incentive compensation she received, Director Hanko estimates that approximately \$1,000 of her total incentive compensation from Baxter could be attributed to MPHS purchases of Baxter products in 2000.” The year 2000 bonus was already received.<sup>3</sup>

3. *Discussion of the Kuperberg Advice Letter A-99-223 and the Miller Advice Letter, No. A-99-019.*

You also cite to two letters in support of your request for reconsideration. The first is the *Kuperberg* Letter,<sup>4</sup> in which you try to equate the source of an alimony payment with the factual situation presented in *Coffey*. The second letter, *Miller*, involves “thousands of individuals who bet on the horse races” and whether they are sources of income to an official who owns a race horse. These letters are factually different from the case at hand and do not bind us. However, since you bring them up, we further explain our analysis below and distinguish the letters.

First, neither of these letters deals with a bonus or employee incentive program, as did *Larsen*, *Anaforian*, and *Coffey*. Specifically, in *Miller*, staff rejected an assertion that the thousands of individuals who bet on horse racing were sources of income to the official/horse owner. This conclusion was based in part on the fact that the bettors had no intent to benefit the official by their wagers and that the official had no face-to-face interaction with the thousands of individuals who bet on the race. Further, it was extremely unlikely that the official could identify the bettors, or determine to what extent they contributed to the official’s share of the purse.<sup>5</sup> This differs dramatically from Director Hanko’s situation. In your *Coffey* letter, the following facts were considered:

- The director’s duties consist mainly of “marketing certain Baxter pharmaceutical products to healthcare providers, including hospitals, long term care providers, surgery centers, and other health services providers.” This included MPHS, for example.

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<sup>3</sup> Note, however, that income, received or promised, is a basis for disqualification for 12 months after receipt or promise.

<sup>4</sup> In your letter you noted the letter number as A-99-232. The actual number is A-99-223.

<sup>5</sup> The follow up letter to *Miller*, *Miller* Advice Letter, No. A- 99-019(a), reveals another difference in the analysis. The argument in *Miller* was that the racetrack itself was not a source of income. The letter discusses the issue. “It is only in unusual circumstances where the Commission or previous advice has ‘pierced’ through entities, such as corporations, which are the apparent source of income, to treat the controlling person as an additional source of income or economic interest of the official’s. [Citations.] In such cases, the advice looked through an entity to find that *an additional* individual or entity should be considered an economic interest of the officials (*sic*). In this case, you argue for looking through the Los Angeles Turf Club to find, in effect, *no economic interest* of the council member’s, because no individual bettor will be a source of \$250 or more in income to him.”

- “Baxter intends Director Hanko’s representation to increase awareness and use of Baxter’s products by healthcare providers within her coverage territory. Baxter therefore provides potential bonus payments to its representatives, including Director Hanko, based on overall sales of Baxter products within the *representative’s* territory.”
- “....Director Hanko can estimate the percentage of overall Baxter sales in her coverage territory attributable to MPHS purchases at Peninsula and Mills hospitals. Based on the year 2000 incentive compensation she received, Director Hanko estimates that approximately \$1,000 of her total incentive compensation from Baxter could be attributed to MPHS purchases of Baxter products in 2000. It is likely (she has not made this calculation) that a somewhat larger amount of her year 2000 incentive compensation could be attributed to purchases of Baxter products by other Sutter-affiliated facilities in her coverage territory.”
- “The District’s Board of Directors, including Director Hanko, will be called upon to give direction to the District’s negotiators, including voting on certain agreements to be incorporated in the final deal, and to ultimately vote to approve or disapprove the final agreements with MPHS, which will likely include Sutter as a signatory to the main or ancillary agreements. Final approval will also encompass the dismissal of the pending litigation.”

The facts of *Kuperberg* are also dissimilar to those in *Coffey* and only minimally address the source of income issue. In that letter we stated: “....Mayor Shea’s former spouse paid child support to her for four years until the youngest child was 18 years old. He currently pays her alimony. Presumably, the mayor’s former spouse did not make a child support payment in the last 12 months. (§ 87103(c).) Moreover, the term ‘income’ excludes alimony and child support payments. (§ 82030(b)(7).) Therefore, Mayor Shea does not have an economic interest in her former spouse as a source of income.” Consistent with the conclusion that the official’s spouse who paid the alimony was not a source of income in the first instance, we went on to conclude that the spouse’s employer was also not a derivative source of income.

The *Dorsey* Advice Letter, No. I-00-176, highlights the factual nature of this question.

“In some of these cases, we have treated two or more persons as sources of a single payment. You may recall that we advised you in 1987 that a personnel services agency, Adia, *as well as its customer*, were sources of income to a public official assigned by Adia to work for the customer. The customer paid Adia and Adia paid the official. (*Dorsey* Advice Letter, No. A-87-176.) Conversely, we generally advise that a contractor is the sole source of income to subcontractors, even though subcontractors are

normally paid from funds collected from the contractor's client.  
(See, e.g. *Sauer* Advice Letter, No. A-95-373.)

"The outcome in these cases turns on the relationship  
prevailing among the parties."

4. *Other Issues.*

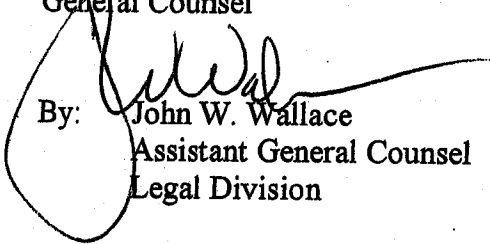
With respect to your last series of questions, all seem to turn on when income is received and when it results in disqualification. Please note:

- Conflicts of interest are based on income *received* or *promised*. "For purposes of the Political Reform Act, a public official's income includes income which has been promised to the public official but not yet received by him or her, if he or she has a legally enforceable right to the promised income." (18703.3(a).) Based on your facts there appears to be no enforceable right to receive the bonus. Thus, the director need only consider the sources of the bonus actually paid to her. Assuming the year 2000 bonus was received at the end of 2000 or early 2001, the 12 months will be running very soon. We also note that income may be declined (or reduced such that the director does not receive more than \$500 attributable to sales to businesses that are directly regulated by her board).<sup>6</sup>
- When the bonus is received, if the share attributable to sales to MPHS (for example) is \$500 or more, then the director will have a conflict of interest in decisions that have a material financial effect on MPHS for 12 months after the payment is received.

If you have any other questions regarding this matter, please contact me at (916) 322-5660. Please note, you may also request the Commission to hear this matter in the form of a Commission Opinion.

Sincerely,

Luisa Menchaca  
General Counsel

By:  John W. Wallace  
Assistant General Counsel  
Legal Division

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<sup>6</sup> In the past we have advised that income is not considered "received" for purposes of the Act if the official signs over the check to a charitable organization and foregoes any income tax deduction for the charitable donation. (*Vose* Advice Letter, No. A-86-318.)